

**ANNUAL REPORT
OF THE
COMMISSION ON STATE TAX AND
FINANCING POLICY**



**Indiana Legislative Services Agency
200 W. Washington Street, Suite 301
Indianapolis, Indiana 46204**

November, 2004

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A copy of this report is available on the Internet. Reports, minutes, and notices are organized by committee. This report and other documents for this Committee can be accessed from the General Assembly Homepage at <http://www.state.in.us/legislative/>.

I. STATUTORY AND LEGISLATIVE COUNCIL DIRECTIVES

The Indiana General Assembly enacted legislation, codified in IC 2-5-3-5, directing the Commission to study and investigate the following:

- (1) the present state, county, and city tax structure of the state of Indiana;
- (2) its revenue-producing characteristics and effects upon the economy of the state of Indiana;
- (3) its equalities and fairness;
- (4) the enforcement policies and administrative practices related to that tax structure; and
- (5) the costs of collection in relationship to the burden of the tax.

IC 2-5-3-5 also gives the Commission statutory authority to examine overall administrative matters, fiscal matters, and procedural problems of the various departments of the state, county, and city governments as they relate to tax and financing policy. In addition, P.L.1-2004, SECTION 82 and P.L.23-2004, SECTION 85, directed the Commission to study alternatives to property taxation. P.L.64-2004 assigned substantially similar responsibilities to the Property Tax Replacement Study Commission.

The Legislative Council assigned the following additional responsibilities to the Commission:

- (1) Charity gaming (HR 49).
- (2) Availability of out-of-state simulcast of pari-mutuel horse racing signals to Indiana licensed facilities (Unnumbered SR).
- (3) Funding issues associated with the Family and Children's Fund and the Children's Psychiatric Residential Treatment Services Fund (Legislative Council).

II. INTRODUCTION AND REASONS FOR STUDY

The reasons for the study of the issues considered by the Commission include the following:

Property Taxation

Assessment procedures were significantly changed for the 2001 general reassessment. As a consequence older property experienced bigger assessment increases than newer property because the depreciation allowance for older property under the old system was largely eliminated under the new system. Also, some types of property, such as residential property, had bigger increases, because other classes of property, such as industrial and commercial property, had always been assessed at values closer to the values required by the new system.

Charity Gaming

In 2003, the Department of State Revenue filed a final rule with the Secretary of State that, among other provisions, would have required organizations to use a predetermined percentage of their gross receipts from charity gaming for charitable purposes in addition to the statutory requirement that all of the organization's net receipts from charity gaming be used for the organization's charitable purposes.

Simulcast of Pari-Mutuel Horse Racing

The Indiana Horse Racing Commission recently considered a proposal to shut off simulcast signals originating in Kentucky to all locations in Indiana. The Indiana Horse Racing Commission eventually ruled in favor of maintaining the status quo.

Family and Children's Fund and the Children's Psychiatric Residential Treatment Services Fund

The Department of Local Government Finance changed the method that was used to calculate a county's annual levy for the Family and Children's Fund after SEA 1 (2004) was enacted. HEA 1001 (2004) contained similar language. The change resulted in a downward adjustment of levies budgeted for 2004. The Children's Psychiatric Residential Treatment Services Fund was established in HEA 1001(2003) to fund a portion of the services previously funded through the Family and Children's Fund beginning in 2004. The Children's Psychiatric Residential Treatment Services Fund has a property tax levy formula similar to the Family and Children's Fund

Wage Equity

Representative Linda Lawson introduced House Resolution 7 in the 2004 session requesting a study of the topic of equal pay for men and women.

Retirement Benefits

No thirteenth check (i.e., a one-time additional distribution to retired public employees) has been paid for two years. The last thirteenth check was authorized by P.L.285-2001 (HEA 1815). The Act authorized thirteenth checks to be paid in 2001 and 2002.

III. SUMMARY OF WORK PROGRAM

The Commission met three times, once in Gary and twice in Indianapolis. At its first meeting, the Commission heard testimony concerning the effect of the property tax reassessment on taxpayers and funding issues associated with the Family and Children's Fund and the Children's Psychiatric Residential Treatment Services Fund. At its second meeting, the Commission heard testimony concerning charity gaming and simulcast of pari-mutuel horse races. At its third meeting, the Commission heard testimony concerning the rule governing annual adjustments of assessed values, proposals from the Department of Local Government Finance concerning changes in the property tax laws, wage equity, and the funding of teacher retirement benefits. The Commission adopted its final report at the last meeting by a majority of the members appointed to serve as voting members on the Commission. The Commission also received the Department of Local Government Finance report required by HEA 1001(2004), SECTION 73 and SEA 1(2004), SECTION 70 entitled "Indiana Uniform Property Tax Management System—Feasibility Study".

IV. SUMMARY OF TESTIMONY

The Commission heard testimony from 45 witnesses. The Commission received testimony on each of the topics assigned to the Commission, including the following:

Property Taxation: Reassessment

The increased tax liability imposed on homeowners as the result of the reassessment has severely affected the ability of some homeowners to retain ownership of their homes. The rapid and substantial increase in tax liability affected both young and older taxpayers in all income categories. The effect was particularly pronounced in northern Lake County where several large industries saw substantial reductions in their bills. The General Assembly has taken a number of actions to provide for a uniform and equal rate of property assessment and taxation and to prescribe regulations to secure a just valuation for taxation of all property.

In 2001, the General Assembly enacted HEA 1902(2001). The bill required the Department of Local Government Finance (DLGF) to contract with an accounting firm (with respect to Lake County) to:

- Report on expenditures from the County Reassessment Fund
- Reassess real property for the general reassessment to be completed for the March 1, 2002 assessment date
- Review succeeding general reassessments to identify assessment disparities that are then subject to correction by the Department.

The bill also provided that a taxpayer could appeal the March 1, 2002 reassessment value directly to the Department. The cost of this contract is to be paid from the county reassessment fund.

The bill also provided a state income tax credit for property tax paid on homesteads for certain low income taxpayers in Lake County. It provided that the credit was to be funded from Gaming Admissions Tax revenue that would otherwise be paid to Lake County and the three largest cities by population in the county. The income tax credit was first available on 2001 income tax returns (filed in 2002). The credit was claimed on 18,955 income tax returns at a total cost of \$5.4 M in 2002.

The law enacted in HEA 1902(2001) has been amended several times since its enactment. The amendments did not significantly change the substance of HEA 1902(2001). However, as noted later in this report, SEA 1001(2004) and HEA 1001(2004) enacted additional provisions similar to the provisions in HEA 1902(2001) and extended those provisions to all counties that had not completed the 2002 general reassessment in a timely fashion.

In 2002, the General Assembly enacted a major tax restructuring bill, HEA 1001(2002)(ss). This bill had many parts. Among them were:

- Establishment of a new \$35,000 standard homestead deduction for primary owner-occupied residences (beginning assess 2002 pay 2003).
- An increase of the homestead credit from 10% of gross taxes to 20% of net (after PTRC) tax (beginning assess 2002 pay 2003).
- Introduction of a new PTRC credit equal to 60% of the school General Fund levy for both real and personal property (beginning assess 2002 pay 2003).
- Re-institution of the 35% inventory adjustment and the 10% Construction in Progress assessment level for personal property (beginning assess 2002 pay 2003).
- Reversion to the old depreciation schedule for personal property (beginning assess 2003 pay 2004). The old schedule has lower “percent good” factors but revived the 30% assessment floor.
- Exemption of manufacturers’ raw materials and work-in-process inventory from taxation if the inventory will be part of a finished good that will be shipped out of state (beginning assess 2003 pay 2004).
- 100% deductibility of all inventory (beginning with assess 2006 pay 2007 taxes), with a county option to eliminate tax on inventory sooner.

In 2003, the General Assembly enacted HEA 1858(2003). The bill created a fifth pool in the depreciation schedule that a personal property taxpayer may elect to use instead of using the other four pools in valuing integrated steel mill or oil refinery/petrochemical equipment. The value of property in this pool is not subject to the 30% floor. Taxpayers who elect to use Pool 5 are not permitted to take any obsolescence adjustments. The statute states that obsolescence has already been reflected in the new depreciation schedule. This measure will first affect assess 2003 pay 2004 property taxes. It did **not** affect the taxes payable for the assess 2002 pay 2003 tax year (including the provisional billing in 2003 and the reconciliation bills).

In 2004, the General Assembly enacted SEA 1(2004) and HEA 1001(2004). These bills will have an impact on property taxes beginning with the assess 2003 pay 2004 tax year and include the following provisions:

- Removal of a taxing unit's unused levy authority, if any, from previous years. This removes the ability of a unit to increase its operating levy by more than the annual growth quotient limitation. (The annual growth quotient limitation is equal to the six year average annual increase in Indiana non-farm personal income.)
- Assessed value used to calculate rates must be equal to the actual assessed value with no adjustments for appeals. This measure could lower tax rates to some degree, initially.
- Taxing units may retain no more than 100% of certified levy in a year. Collections over 100% must be used to reduce future tax levies. The old law allowed units to retain 102% of certified levy. This measure will reduce some property tax levies by up to 2%.

SEA 1(2004) and HEA 1001(2004) made two additional changes of note. It added IC 6-1.1-4-35 through IC 6-1.1-4-38 to establish a procedure similar to the assessment procedure added by HEA 1902(2001) for Lake County. It also directed the Commission on State Tax and Financing Policy to study alternatives to property taxation. P.L.64-2004 assigned substantially similar responsibilities to the Property Tax Replacement Study Commission. The Property Tax Replacement Study Commission is required to complete the study required by P.L.64-2004 in 2004. The Commission on State Tax and Financing Policy is required by SEA 1(2004) and HEA 1001(2004) to complete its study by 2005.

Property Taxation: Annual Assessed Value Adjustments

IC 6-1.1-4-4.5 requires a system for annually adjusting the assessed value of real property to account for changes in value in those years after a general reassessment of property last takes effect. The system must be applied to adjust assessed values beginning with the 2005 assessment date (for property taxes first due and payable in 2006) and each year thereafter that is not a year

in which a reassessment becomes effective. The proposed annual adjustment rule was published at 27 Indiana Register 4050 (September 2004).

Property Taxation: Legislative Recommendations

The Department of Local Government Finance recommended that various legislative proposals be enacted. The following proposals were presented to the Committee:

- (1) Extend property tax abatement programs due to sunset on December 31, 2005.
- (2) Extend authorizing statutes for tax increment financing (TIF) arrangements due to sunset on December 31, 2005.
- (3) Replace parts of IC 6-1.1-13 and IC 6-1.1-14 with rulemaking authority.
- (4) Repeal land value commissions.
- (5) Modify statutes to be consistent with the Department's equalization rule and annual adjustment process.
- (6) Repeal the rule that cost, depreciation, and reproduction cost schedules must appear in the assessment manual.
- (7) Give the Department more flexibility in handling appeals.
- (8) Give the Department more authority to require Lake County to pay for the appeals process.
- (9) Give the Department authority to prescribe computer systems used by county auditors.
- (10) Fund and implement a unified property tax software system that would integrate all 92 counties with state-level systems.
- (11) Make various other technical changes

Family and Children's Fund and the Children's Psychiatric Residential Treatment Services Fund

Restricting the county family and children property tax levy in a year to the amount of the levy actually imposed in the preceding year multiplied by an assessed value growth quotient limits a county's flexibility to respond to annual fluctuations in the number of children reported as abused or neglected, the number of children needing placement, and the number of children who are able to be returned to their families or adopted. Testimony given to the Commission on State Tax and Financing Policy included recommendations similar to those adopted by the Indiana Commission on Abused and Neglected Children and Their Families. In its report dated August 15, 2004¹, the Indiana Commission on Abused and Neglected Children and Their Families recommended that

¹ Indiana Commission on Abused and Neglected Children and their Families, Putting Children First, <http://socialwork.iu.edu/media/Final%20Report-CCAN1.pdf>, August 15, 2004, p. 18.

the General Assembly carve out the Family and Children's Fund from the growth caps and limits on the banking of unused tax levies that were imposed as a result of legislation enacted in the 2004 Session. To bring counties within a levy limit based on actual levies imposed in the preceding year, the Department of Local Government Finance eliminated \$20,400,000 in levies that had been appropriated to the Family and Children Funds by the 92 county councils for 2004. The Commission passed its recommendation with a rating of highest priority with rapid implementation and encouraged that it become effective July 1, 2005. (See PD 3536 (2005), which was distributed to Commission members, for language related to this proposal.)

The Commission on State Tax and Financing Policy did not receive testimony on the Children's Psychiatric Residential Treatment Services Fund.

Charity Gaming

The Department of State Revenue takes the position that the conduct of gaming by an exempt organization is not a charitable activity. The position of the Department is that gambling is not a charitable activity and the use of the net proceeds of a gaming event for a charitable purpose does not convert the gaming event into a charitable activity. As a result, to maintain the nonprofit character of a gaming event, a significant percentage of the gaming gross receipts should be devoted to charitable purposes.

The Department's final rule on the subject was published in the April 1, 2003 issue of the Indiana Register (LSA Document #02-40(F)). The rule reads, in part, as follows:

45 IAC 18-3-7 Use of proceeds

Sec. 7. (a) In accordance with IC 4-32-9-16, as a condition of receiving a charity gaming license or nonlicense letter issued on or after May 1, 2003, the following minimum percentage of charitable gaming gross receipts shall be used for those lawful religious, charitable, community, or educational purposes for which the organization is specifically chartered or organized, or those expenses relating to the acquisition, construction, maintenance, or repair of any interest in real property involved in the operation of the organization and used for lawful religious, charitable, community, or educational purposes:

- (1) Five percent (5%) for organizations with annual gross receipts less than one hundred fifty thousand dollars (\$150,000).
- (2) Eight percent (8%) for organizations with annual gross receipts between one hundred fifty thousand dollars (\$150,000) and five hundred thousand dollars (\$500,000).
- (3) Ten percent (10%) for organizations with annual gross receipts over five hundred thousand dollars (\$500,000).

Unless an organization has derived no gross receipts in the prior fiscal year, the

gross receipts of the most recently completed fiscal year shall be used to determine the applicable percentage for the use of proceeds requirement. An organization with no prior charitable gaming activity shall be subject to a five percent (5.0%) minimum use of proceeds requirement. (*Department of State Revenue*; 45 IAC 18-3-8; filed Feb 28, 2003, 2:16 p.m.: 26 IR 2308)

The gross receipts rule was enjoined by a court for failure of the Department to submit an economic impact statement, as required by IC 4-22-2-28. *Veterans of Foreign Wars Post 9395, et al. v. Indiana Department of Revenue*, (Marion County Superior Court, Cause No. 49D10-0306-PL-001148) (2004). Many nonprofit organizations regard the rule as a burdensome and overly broad requirement. They suggest that the Department focus on identifying and disciplining the small number of operators who have committed illegal or unethical behavior.

Simulcast of Pari-Mutuel Horse Racing

Federal law grants the Kentucky Horsemen's Benevolent and Protective Association the right to object to requests to import the signals for races conducted in Kentucky. The Kentucky Horsemen's Benevolent and Protective Association objected to a plan to import the signal to the Evansville and Clarksville satellite facilities. They are currently broadcast to the Indiana race tracks in Anderson and Shelbyville and to the satellite facilities in Indianapolis, Fort Wayne, and Merrillville. Various parties suggested that a negotiated resolution would be more likely if the Kentucky signal is banned either administratively or legislatively. Ohio recently has enacted a statute that bars out-of-state signals unless the signals are available to everyone.

Wage Equity

Representative Linda Lawson introduced HB 1487 in the 1999 session of the General Assembly. The bill, which was not enacted, would have given employees access to more information about employers' criteria for rates of pay in all types of employment. In 2003 the Coalition for Wage Equity in Indiana recommended to the Indiana House Trade and Labor Study Committee that a summer study session be devoted to exploring the need for the legislature to fund a full-scale study of the extent, causes, and consequences of the pay gap with regard to gender, race and national origin.

Bureau of Labor statistics estimate that women will make up about 48 percent of the labor force in 2008. In 1988, women represented 45 percent. The Institute for Women's Policy Research notes that the number of families that rely for survival on income earned by both spouses and the number of women head of households who must depend on the income they earn for the survival of their household is increasing. AFL-CIO research suggests that the gap between the wages paid to men and the wages paid to women for comparable jobs costs working families \$200 billion of income annually.

According to a study published in October 2003 by the United States General Accounting Office, the pay gap between women and men who work full-time, year-round has grown in the past 20 years. The GAO study tracked the work careers of 9,300 people for 18 years. The study used statistical modeling, analyzed existing studies, and included interviews with employers and earnings experts. The study found that women's pay, even after accounting for such factors as education, job tenure, part-time work, and time-off for childbearing, is less than men's pay.

Pay inequity between the sexes has been a particular problem in Indiana, which was recently rated as having the third largest gender gap in wages in the United States. According to the AFL-CIO Working Women's Department, Hoosier women earn \$0.66 for every dollar earned by Hoosier men. Hoosier women of color fare worse, earning \$0.93 for every dollar earned by Hoosier women classified as white by the United States Census Bureau.

Job classification explains some of the wage gap. The federal Equal Pay Act is insufficient to overcome the problems associated with job classification. A pay differential between two positions with identical work must be found for a finding of wage discrimination to be made. Laws allowing comparisons between positions of "comparable worth" (i.e., jobs with similar levels of responsibility, skill, experience, effort, and working conditions) are needed to resolve discriminatory job classification issues.

One possible contributor to the problem in Indiana is the fact that Indiana did not implement pay equity adjustments based on gender when many other states were doing so in the early 1980's. The efforts in other states to reduce pay inequity were based on point systems that evaluated public sector jobs to ensure that jobs of comparable worth, as defined in terms of working conditions, skill, education and responsibility, received comparable pay.

Market reimbursement rates for unskilled labor and educational attainment differences between men and women also affect wage equity. For example, the Institute for Women's Policy Research found that women leaving welfare usually are placed in or are only able to obtain low-paying jobs. Helping poor women acquire better skills, which would lead to better jobs, would greatly improve their odds of achieving economic success and being better able to support themselves and their families.

Additional statistical analysis of wage data is needed to craft a legal solution. In addition, additional policy discussion is needed to select among the various alternative approaches available to address the problem. Establishing a broad-based commission or developing a collaborative effort among existing commissions to direct the work would aid in solving wage equity issues.

Retirement Benefits

The last thirteenth check authorized by the General Assembly amounted to \$100 for most retired public employees. The Retired Indiana Public Employees Association, Inc. recommends that the practice be continued. The Association notes that the Public Employees Retirement Fund is actuarially funded. It has sufficient money to pay for additional thirteenth checks and cost of living adjustments for its members.

The Association attributes the recent failure of the General Assembly to authorize additional thirteenth checks for the members of the Public Employees Retirement Fund to concern that sufficient money is not available in the Teachers' Retirement Fund to give a similar benefit to members of that Fund. In particular, they note that the Teacher's Retirement Fund has realized lower earnings on the money deposited in its Annuity Reserve Account than it was earning during the time in which thirteenth checks had been authorized.

V. FINDINGS AND RECOMMENDATIONS

The Commission made no findings or recommendations.

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